



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201403017**

Release Date: 1/17/2014

Date: October 24, 2013

UIL Code: 501.36-01
501.33-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Kenneth Corbin
Acting Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: 8/9/13

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

O = State
P = City
Q = Date
S = Name of Company

UIL:

501.33-00
501.36-01

Dear :

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Issue

Do you qualify for exemption under section 501(c)(3) of the Code? No for the reasons described below.

Letter 4036(CG) (11-2011)
Catalog Number 47630W

Facts

You were established as S in 1994 under a university's economic development outreach program. You changed to your current name in 1996 with the mission to promote economic development and competitiveness by educating, sponsoring, developing and implementing electronic commerce (e-commerce) activities and programs to small and medium-sized businesses and non-profit groups.

You incorporated with the state of O on Q as a new separate entity. Your purpose in pertinent part is: "charitable scientific and educational purposes within the meaning of Section 501(c)(3)..."

Your core mission since inception has been to train and educate small businesses and organizations to learn how to use and implement internet technology for growth and expansion of their businesses. You provide a variety of specialized courses in a variety of subjects. Your goal has always been to first provide training and classes and then provide technical assistance as needed. You help "hand-hold businesses through internet complexities". Approximately 55% of your activity is conducting your educational courses, training and consulting.

The other 45% of your activities are focused on providing technical services and consulting. You meet with a prospective client and evaluate their knowledge and experience with technology. You provide a review of existing websites and make recommendations on what technology will help to grow their business, improve sales and make them more efficient. You do not have set fees but you approach each client based on their needs. Your hourly fees range from \$50 to \$90 per hour. You also charge project fees that range from \$500 to \$3500. A typical consulting contract will include website development, database development, and internet marketing such as on-line shopping carts, logo and corporate identity design, search engine optimization and social media implementation. Additional fees for web hosting, support, e-mail accounts and training will be charged. Projects undertaken by you require your clients to remit 50-75% of the project cost along with a signed statement of work before work can begin. Web hosting services automatically renew on an annual basis unless terminated by either party. When comparing fees to the industry, you state your fees are not the most expensive nor are they the cheapest charged for similar technical assistance support.

You also provide consulting and technical assistance to two of your board members. This service is provided at arms length and these board members pay full costs for any work provided by you.

You have partnered with government entities and other organizations in O to solicit

small and medium size businesses through "matching grants" programs. You will solicit small to mid-sized businesses to offer your technology, educational and developmental services. The programs are primarily targeted towards small and disadvantaged businesses to provide matching funds to these businesses within the participating localities. The municipality or economic development authority is solicited to participate for the benefit of businesses within their areas. You also work with large banks and business enterprises that offer matching grants to grow businesses in their areas of influence. You do not operate particularly in an area that is blighted or economically backward. Although you provided a listing of the economically distressed regions and federal unemployment data for O, you operate throughout O, wherever you are able to obtain matching grants. Your activities are not aimed at combating community deterioration and you do not provide loans to start-up businesses.

Businesses located within participating localities who request your consulting and other services are provided with matching grants that fund up to 50% of the project costs available to businesses through these entities. Payments of matching grants are made through you based on a 50-50 match basis with a maximum cap. The matching program is not limited to you. Any vendor who is approved and provides internet technology services can participate in this program.

For example, you have an agreement with an agency of P that provides "E-Commerce Business Assistance Grants" to eligible businesses to fund technology improvement or development projects that expand and grow their businesses. The grants reimburse you up to 50 percent of the project costs. The business clients pay you the remaining project costs. Certain large companies also provide these grants that target vendors of their products. Your project contracts identify these matching grants as reductions to the total fees due from your clients.

You collaborate with various business assistance organizations such as the Small Business Administration (SBA) and other such departments across O as well as other businesses to sponsor your educational classes. When sponsorship grants are not available for a particular seminar or class, you might charge participants a minimum fee which helps offset expenses of the classes. You state your technical service fees also help in part to underwrite your educational classes.

You operate throughout the O. You tend to focus on small, women owned and minority owned businesses and assist them by providing education and technical support. You attract clients through the matching grants program and a word of mouth marketing program. Current and previous clients also refer new business to you. You also use your education classes to attract new clients that are looking for consulting and technical assistance. Approximately 70% of your client base is made up of small, minority owned and women owned businesses.

You conduct one to four educational programs a month. Depending on your program locations, you estimate 20 to 30 people attend your educational classes and sessions, with lesser in the rural locations. Some individuals may attend several of your educational classes since your topics provide relevant information meant to improve their business and increase their profits.

To complete your package of services to your clients you also publish and sell a book written by a best selling author which your clients can buy by clicking on a link on your website.

You have no specific criteria for a business to obtain your services. However you will rely on the business being eligible for a matching grant that is available in a particular locality.

Your first fiscal year shows income received from clients for new projects and renewals account for approximately 70% of your income. Matching grants and contributions etc make up approximately 30% of total income. For your next two fiscal years your estimates show your gross receipts are approximately 79% and 83% of total income respectively. Payments to contractors and payroll expenses constitute the bulk of your expenses.

Law

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax to organizations organized and operated exclusively for charitable, religious, scientific, or educational purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (regulations) provides that in order to be exempt under section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more purposes specified in such section. An organization that fails to meet either the organizational test or the operational test is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization operates exclusively for exempt purposes if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3) of the Code. An organization will not meet exemption if more than an insubstantial part of its activities fails to further an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather

than a private interest. To meet this requirement, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations defines the term "charitable" as used in section 501(c)(3) of the Code. It includes the relief of the poor and distressed, lessening the burdens of government, and the promotion of social welfare by organizations designed to lessen neighborhood tensions, eliminate prejudice and discrimination or combat community deterioration and juvenile delinquency.

Section 1.501(c)(3)-1(d)(3)(i) of the regulations defines the term "educational" when used in section 501(c)(3) of the Code as the instruction or training of an individual for the purpose of improving or developing his capabilities or the instruction of the public on subjects useful to an individual and beneficial to the community.

Revenue Ruling 71-529 held that a nonprofit organization that provided assistance in the management of participating colleges' and universities' endowment or investment funds for a fee substantially below the cost of providing such service, qualified for exemption under IRC 501(c)(3). Membership was restricted to colleges and universities exempt under section 501(c)(3) of the Code, and its board of directors was composed of representatives of the member organizations.

Revenue Ruling 72-369, 1972-2 C.B. 245, states that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

Revenue Ruling 74-587, 1974-2 C.B. 162, held that a nonprofit organization formed to relieve poverty, eliminate prejudice, reduce neighborhood tensions, and combat community deterioration through a program of financial assistance in the form of low-cost or long-term loans to, or the purchase of equity interests in, various business enterprises in economically depressed areas is exempt under section 501(c)(3) of the Code.

Revenue Ruling 76-419, 1976-2 C.B. 146, held that a nonprofit organization that purchased blighted land in an economically depressed community and converted the land into an industrial park and encourages industrial enterprises to locate new facilities in the park in order to provide employment opportunities for low income residents of the area, is operated exclusively for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services did not satisfy the operational test under section 501(c)(3) of the Code because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, or scientific, but rather commercial. In addition, the court found that the organization's financing did not resemble that of the typical section 501(c)(3) organizations. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation did not limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In Airlie Foundation v. Internal Revenue Service, 283 F.Supp.2d 58, the court held that Airlie Foundation did not meet the requirements as an organization described in section 501(c)(3) of the Code because its operation of a conference facility was a commercial activity. The foundation charges conference fees comparable to or lower than other nonprofit conference centers and substantially lower than commercial conference centers. It advertises only from their website and it retains very small earnings from their operations. While many of their clients were exempt and nonprofit organizations and government entities, many others were corporate or private clients conducting special events and weddings. The court conceded that certain factors, including their fee structure and subsidization practice, emulate noncommercial characteristics; however, other factors, such as the nature of their clients and industry competition, gave the activities a commercial hue. Thus, the court concluded their manner of operations furthered substantial nonexempt purposes.

In Asmark Institute, Inc. v. Commissioner of Internal Revenue, 486 Fed.Appx. 566, TC Memo 2011-20, the appeals court upheld the tax court decision that Asmark Institute is not entitled to exempt status under section 501(c)(3) of the Code because the institute's operations were commercial rather than charitable. Its activities consist mainly of compliance services for a fee. The court also found that Appellant's free services are relatively small in relation to all of its services and are, in fact, tied in some manner to fee-based membership. The court also found that the appellant's largely fee-based business plan and its competition within a for-profit market were also strong evidence of the predominance of their nonexempt commercial purposes. The tax court concluded it was apparent from the record that appellant's consulting services are mainly associated

with the fees appellant receives through its various retainer agreements, membership agreements, and service packages. The sale of services, including consulting services, is commonly considered to be a non-exempt, commercial purpose.

Application of Law

You are not described in section 501(c)(3) of the Code and section 1.501(c)(3)-1(a)(1) of the regulations. You fail the operational test for exemption under 501(c)(3) because you are operated in a commercial manner.

A substantial part of your activities are commercial. You provide services to your clients such as website development, database development and internet marketing tools to increase their business and profits. You charge an hourly fee as well as a project fee which are based on your cost. At times your cost is subsidized by local economic development agencies or corporations at the rate of 50%. Although a portion of your clientele are small businesses and women owned and minority owned business you provide your services at or above cost. These facts demonstrate a commercial and substantially non-exempt purpose inconsistent with section 501(c)(3) of the Code and Section 1.501(c)(3)-1(c)(1) of the regulations.

You operate for the private interests of your client businesses for whom you provide various website services for a fee. You also operate for the private interest of the author of the book that you sell to your clients through a link on your website. Therefore you are not organized or operated exclusively as described in Section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

Your services are not designed for the relief of the poor and distressed, to lessen the burdens of government or the promotion of social welfare. Your services are provided to any business that can afford your services or obtain a matching grant for 50% of the cost of the project and can pay the other 50% of the cost directly to you. Therefore, your activities are not charitable as described in section 1.501(c)(3)-1(d)(2) of the regulations.

Although you provide educational seminars, these seminars are a way for you to obtain additional clients for whom you can provide your services for a fee. Your educational activity is incidental to your primary activity which is to provide website and other related technical services to your clients for a fee. You conduct your educational activities from the perspective of possibly bringing in more paying clients whose revenue sources will help fund your educational programming. Therefore you are not as described in section 501(c)(3)-1(d)(3)(i) of the regulations.

Your fee-based service activities are similar to those described in Revenue Ruling 72-369 and in the court cases BSW Group, Inc., Airlie Foundation, and Asmark Institute.

As in these four situations, you operate in a commercial manner. You provide technical and consulting services and support to clients who seek your services for a fee. Most, if not all, of your clients are for-profit businesses and you assist them to increase their business and their profits. You do not restrict your clients to other organizations exempt under section 501(c)(3) of the Code. In addition, your fees are not substantially below cost. You are operating a trade or business with the public similar to and in competition with commercial operations providing similar technical, consulting and marketing services and support.

You are not similar to the organization described in Revenue Ruling 71-529 because you are not providing services for a fee substantially below cost to other organizations exempt under section 501(c)(3) of the Code. You are also not similar to the organizations described in Revenue Ruling 74-587 or 76-419 because you do not operate in an economically depressed area or a distressed area. You do work with and provide services to some minority-owned businesses, but it is because they meet the criteria set by the matching grant programs. In those programs, the matching grant funds are paid as direct reimbursements of the service costs. You do not provide loans or provide assistance to businesses that have trouble obtaining such assistance because they operate in economically distressed or deteriorated areas. Your assistance is available to any business including minority owned and women owned businesses that can afford your hourly and project fees either wholly or with matching grant funds.

You are similar to Better Business Bureau of Washington, D.C., Inc. because you too have a substantial non-exempt purpose. Even though you have some educational activities, the facts overwhelmingly show you operate for a substantial non-exempt commercial purpose and you also operate for the benefit of private business interests..

Applicant's Position

Your goal is to first provide training and classes and then provide technical assistance as needed. Your fees are not the most expensive nor are they the cheapest fees that companies charge for similar technical assistance support. Your unique mission of providing education, consulting and technical assistance makes it difficult to compare your fees with services provided by other providers. You provide hours of educational support to potential clients or existing clients for which they never receive a bill.

Your mission is to provide e-commerce education, internet training, consulting and technical assistance specifically targeted to minority businesses. These minority businesses will hire other individuals after their business has grown as a result of the internet capabilities provided by you thereby saving existing jobs and creating new jobs to handle the growth in their respective businesses. You have oftentimes been referred to as an incubator.

Service Response to Applicant's Position

The fees you charge are based on market rates depending on your client needs. The provision of some free consultations or education does not take away from the fact that you are similar to other for-profit consulting companies that charge a fee for services.

The fact that your services assist business growth and creates jobs does not alone justify exemption or overcome the commercial nature of your operations.

Conclusion

Based on the above facts and analysis you do not qualify for exemption under section 501(c)(3) of the code because you are not operated exclusively for a 501(c)(3) purpose. The facts show you operate for a substantial non-exempt commercial purpose as you were formed to provide various internet related services to your clients for a fee. Accordingly we conclude you do not qualify for exemption under section 501(c)(3).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of why you disagree. Your protest statement must be filed within 30 days of the date of this letter and should include:

- Your organization's name, address, EIN number and a daytime phone number.
- A statement that the organization wants to protest the proposed determination.
- A copy of this letter showing the findings that you disagree with (or the date and IRS office symbols from the letter.
- An explanation of your reasons for disagreeing including any supporting documents.
- The law or authority if any, on which you are relying.

The protest statement may be signed by one of your officers or your representative,. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *How to Appeal an IRS Decision on Tax-Exempt Status*.

The protest statement should also include the following declaration.

"Under penalties of perjury, I declare that I have examined this protest including accompanying documents and, to the best of my knowledge and belief, the statement contains all relevant facts, and such facts are true, correct, and complete."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your protest will be considered incomplete without this statement.

If an organization's representative signs and submits the protest, a substitute declaration must be included stating that the representative prepared the protest and any accompanying documents; and whether the representative personally knows (or does not know) that the statement of facts in the protest and any accompanying documents are true, correct..

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. In that case you must file a Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to seek a declaratory judgment in court at a later date because the court requires that you first exhaust administrative remedies. At the IRS. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Deliver to:

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Kenneth Corbin
Acting Director, Exempt Organizations

Enclosure: Publication 892